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China, Peoples Republic of

Retail Food Sector

Supermarket Destinations in Southwest China

2008

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Report Highlights:

Less foreign competition, burgeoning demand, and regional interest in food make Southwest China's food retail sector a prime target for U.S. exports. There are three main channels for distributing products to Southwest China: local distributors, regional distribution centers, and importer direct. Degree of centralization of purchasing determines method of entry into upscale hypermarkets, as does the type of product.

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I. Southwest China: Rapid Growth and Import-Hungry Emerging City Markets

ATO Chengdu covers Southwest China, including Sichuan, Chongqing, Yunnan, and Guizhou provinces. One in every 33 people on earth lives in Southwest China. With a population of over 200 million and a regional gross domestic product (GDP) of \$290 billion in 2007, the area is twice the size, six times the population, and three times the GDP of Central America. The economic growth the region is experiencing is raising incomes and increasing the market for foreign products. The region is also known for its passion for food. Consumers are keen to try imported products and are willing to pay a premium for a quality product.

According to some estimates, middle-income consumers now represent almost 35 percent of urban population and at current growth rates will exceed 50 percent by 2010 and 7 percent of the total population by 2015. Economic growth in the provinces of Southwest China is some of the highest in the world, averaging between 12.0 and 15.6 percent in 2007. Growth in the regions two largest emerging city markets (ECMs) in the region, Chengdu and Chongqing, accounting for 20 percent

of the region's population, reached 17 and 18 percent, respectively, in 2007.

Table 1: Rapid Growth in Value of Imports by Province

Region	Imports (million USD)		2006 Growth in Imports
	2005	2006	
Sichuan	3200.36	4396.70	37.4%
Chongqing	1772.26	2118.66	19.5%
Yunnan	2101.72	2833.34	34.8%
Guizhou	544.63	579.28	6.4%

Source: 2007 China Statistical Yearbook

Table 2: Southwest China Hypermarket Retailer Distribution

Retailer	Ownership	Chengdu Outlets	Chongqing Outlets	Kunming Outlets
Carrefour	French	5	4	4
Metro	German	1	1	1
Ito Yokado	Japanese	3	0	0
Isetan	Japanese	1	0	0
Auchan	French	3	0	0

Chengdu: An Emerging City Market Ripe for Development

The markets of Southwest China are less saturated with imports than developed port cities, providing several advantages to marketing products in the region. There is less foreign competition despite burgeoning demand. In addition, marketing dollars go further because new imports face less foreign competition in Southwest China than in the more developed port cities. Finally, Sichuan food plays a leadership role in food trends. It is held in high esteem across China and influences both the national market and other regional markets.

Chengdu, the capital of Sichuan province, is the wealthiest and most advanced city in the region. Chengdu currently has the largest market for imported products. Chongqing is growing rapidly, but incomes have not risen to the levels of Chengdu yet, so it has a smaller consumer base. Incomes in Kunming and Guiyang are not as developed yet. Outside of Metro in Chongqing, which has large contracts for imported products with Yangtze riverboat tours, hypermarkets in these cities carry a smaller percentage of imported products than in Chengdu.

Getting Your Product to Market: Local Distributors, Importer-Direct, and Regional Distribution Centers

There are three main channels for distributing products to Southwest China: local distributors which purchase their product from port cities and then sell their products to retailers; regional distribution centers, normally associated with a single retailer; and importer direct, when retailers often working with a referred importer bring products directly from the port. Regional distribution centers are responsible for purchasing and logistics for regional and national stores. Importer direct tends to be exercised by chains with less national presence, like Ito Yokado, or with highly perishable products.

Products directly purchased from port city importers and shipped directly to retailers or their central distribution centers are largely cash transactions. A significant quantity of imported products is purchased by local distributors from port city importers and then sold to the retail market. Most transactions with local distributors are carried out on a credit basis. Local distributors take on some of the retail risk by agreeing to the returns of expired or unsold products.

Upscale Hypermarkets Require Two-Pronged Approach

The higher-end hypermarkets tend to use national distribution systems, often using national purchasing managers. Metro uses this model. Retail chains with more centralized purchasing systems give local store managers less control over which imported products are on their shelves. The less centralized retailers give their local managers more control of what products are in stores, but often what is available is still determined by regional or national hubs. Carrefour and Auchan fall into this model.

Lower-End Retailers' Local Distributors a Barrier to Introducing Imports

Lower-end hypermarkets and supermarkets tend to use local distributors for their products. Local distributors provide more favorable terms with retailers, including paying slotting fees and selling products on credit. As a result, local distributors are reticent to offer unfamiliar foreign products with unknown market potential. Combined with the reduced purchasing power of low end retail consumers, this makes breaking into lower-end segment of the retail sector difficult.

Meats, Produce, High Value and Value-Added Products: Product Influences Marketing Channels

The majority of imported meats are purchased by retailers or their distribution centers directly from port city importers. Most imported meat is frozen. Imported fresh fruits and vegetables frequently are handled by local wholesalers. While produce is generally locally purchased, some is directly purchased from importers. Imported processed foods are the most likely to go through local distribution channels, especially when there is no central distribution system. These local distributors will often arrange more favorable terms of agreement than central distributors in port cities, for example return of expired or unsold products. They often work on commission. In addition, local distributors tend to promote imported products through retailers to increase product sales.

Strong Growth Opportunities for Those Who Overcome Logistical Challenges

Consumers are interested in quality food products, and the local food culture promotes experimenting with new food products. Another asset is the reputation of U.S. products. They are held in high esteem for their quality and safety.

Key obstacles include logistics and knowledge of how to use new-to-market products. The distance from major port cities such as Shanghai and Shenzhen is a challenge for some U.S. imports. Except for air transport, port to retail transportation time is from two to five days, and the cold chain is not always reliable.

Table 3: Market Entry into Southwest China

Advantages	Challenges
Growing middle class: An estimated 35% of the 65 million urban residents in Southwest China are middle class or higher. This is projected to reach 50 percent by 2010.	Intellectual property rights: fraudulent labeling of domestic products as imports, imports via grey channel relabeled as "Made in China"
U.S. products valued for safety and quality	Strong local competition for fresh produce and some meat products
Sichuan cuisine sets trends for "Chinese" cuisine throughout all of China	Limited infrastructure and distribution, especially for perishable products; weak cold chain infrastructure
Regional interest in trying new foods	Geographical distance from port cities
Retailers receptive to import promotions	Many local customers perceive frozen meat as inferior to fresh products.
Retail outlets increasingly perceived as cleaner, safer than traditional wet markets.	Lack of importer and retailer knowledge and training in purchasing, handling, and merchandising U.S. products

Sidestep Domestic Competition by Marketing U.S. Imports as High Value Products

Differentiating U.S. products' quality, safety, and value capitalizes on their reputation with consumers. The growing number of affluent consumers in Southwest China is willing to pay a premium for a superior product. In response to safety and quality concerns, the presence of "green food," the Chinese equivalent to organic, in the supermarkets has exploded. Superior quality and safety helps to differentiate U.S. products from their domestic counterparts. This is critical when competition is strong, as it is for meats, fruit, and vegetables. For this reason, it is important that the integrity of imported products be maintained throughout the distribution chain from port city to emerging city markets. Further development of the cold chain in many Emerging City Markets is essential for maintenance of refrigerated product quality. For example, a market currently exists for premium non-muscle meat poultry products, like chicken paws and wing tips.

Intellectual Property Rights Violations Pose a Threat to U.S. Product Reputation

Throughout China, fraudulent labeling in the retail sector is a problem, and Southwest China is no exception. An estimated 20 to 30 percent of products are counterfeit. IPR violation harms the reputation for



Convincing counterfeits challenge IPR

quality and safety held by imported U.S. products and cuts into market share. Protecting intellectual property is a critical part of doing business in China. Avoiding infringement requires patent, copyright, or trademark registration with the appropriate Chinese registration office. Companies must also be proactive in pursuing enforcement mechanisms available to halt infringers.

II. Road map for market entry

Upscale Hypermarkets Ripe for Promotion of Imported Products

Hypermarkets targeting the upper income and upper middle income levels are the most promising segment of the retail market for introducing imported products. They have the highest saturation of imported products. Sales of imported products in these hypermarkets represent 3 to 10 percent of revenues, with room for expansion. Predominantly wealthy Chinese consumers purchase these imported products. In Chengdu, there is a relatively small expatriate community, and only an estimated 15 to 20 percent of revenues from import sales are generated by foreigners. Upscale hypermarkets are Metro, Ito Yokado, Isten, Carrefour, and Auchan. The market share of imported products in supermarkets and hypermarkets targeting middle to lower income consumers, i.e. TrustMart and WalMart, imported products is generally less than 1 percent of sales.

Degree of Centralization of Purchasing Determines Method of Entry into Upscale Hypermarkets

The first step to entry into the hypermarket sector is to ascertain the degree of centralization of the purchasing department. Retailers with less centralized purchasing systems give their individual store managers more control over the products that are on their store shelves. In general, it is necessary to work with both the retailer's national import manager, their principle importers, and individual store purchasing managers.

Retailer Fees Can Increase Cost of Selling Product through Certain Retailers

Some retailers are known to increase the cost of doing business by charging slotting fees, shelf fees, festival fees, and chef fees. Some retailers charge promoters fees to have promotions in their stores, while others simply ask that the promoter provide the product to be given out in samples.

In-Store Promotions Essential for Success in Hypermarket Sector

Table 4: Chengdu Retail Market at a Glance			
Targeted Clientele	Retailer	Ownership	# Outlets
HRI, Upper & Upper Middle income	Metro	German	1
Upper and Upper Middle income	Ito Yokado	Japanese	3
	Isten	Japanese	1
Middle and Upper Middle income	Carrefour	French	5
	Auchan	French	3
Lower and middle income	Trust Mart	China/U.S.	10
	WalMart	U.S.	3
	A Best	Chinese	2
	Century LianHua	Chinese	5
	Beijing Hualian	Chinese	4
	Wang Fuding	Chinese	1

In-store promotions like sampling and recipe cards are critical to introduce new-to-market products. Consumers are eager to try new, unfamiliar products, but if they do find uses for the product the first time they purchase it, they are unlikely to purchase it again. One retailer described how the store introduced a high quality biscuit, but over time the majority of the customers that purchased the product were those that had experience with the product overseas. The retailer believed the product would have been much more successful if there had been an in-store promotion with samples to introduce uses of the product.

Profiles of Key Retailers

Metro's clientele is predominantly the Hotel, Restaurant, and Institutional (HRI) sector and other bulk purchasers. Metro has the widest selection of imported products of any of the key retailers, and 10 percent of their sales revenue is from imported products. Metro has a membership system similar to that of Sam's Club or Costco. Their large section of frozen processed foods, including desserts, frozen vegetable mixes, and frozen potato products, is easy to use and open to U.S. products. Metro's main competition is the local wholesale market, not other high-end hypermarkets.

Metro has a centralized distribution system in Shanghai. Local store managers can suggest the introduction of a specific product (imported or domestic) to their stores, but the Shanghai purchasing office makes the final decisions for individual stores.

Carrefour targets predominantly upper-middle class and middle class consumers. Imports constitute between three to five percent of sales. Chengdu Carrefour is the headquarters for the Western Region, which includes the five stores in Chengdu and four in Chongqing. Imported products are ordered by the head office for China, and distribution of imported products is outsourced to Elee Logistics, which manages the logistics and transportation of imports.

Local store managers have the discretion to choose which imported products they wish to order, but the availability of imported products store managers can choose from is determined by the head office based local demand for imported products and the affluence of customers. Stores with higher rankings can choose from a larger list of products.



Modern store layout and appealing presentation: an upscale hypermarket in Chengdu

Ito Yokado and **Isetan** are high-end, Japanese-owned stores that target upper class consumers. These retailers' emphasis on expansion in to these second-tier markets suggests that there is easier access for high-end retailers in the second-tier markets. China wide, Ito Yokado has two stores in Beijing and one store in Chengdu. Isetan's Chinese stores are in Shanghai and the second-tier cities of Jinan, Tianjin, Chengdu, and Shenyang.

Auchan has stores in Shanghai, Beijing, and Chengdu. Its customers are largely upper-middle and middle class consumers. Auchan has a centralized system for import distribution. There is no purchasing center in Southwest China. Its purchasing and distribution department are located in Shanghai.

Demand for Processed Imports in Convenience Stores Expected to Grow

Convenience stores are a relatively new phenomenon in Southwest China. They have a low penetration of imported products. A survey of Chengdu convenience stores by Post found a limited quantity of imported convenience foods, including premium ice cream products, cookies and wafers, and candy products. The three convenience chains in Chengdu—WoWo, Red Flag, and Hu Hui—operate approximately 2,000 convenience stores in Chengdu. This market is newly developing, and market potential for targeted convenience foods, like nuts and dried fruits, is expanding rapidly.



Break in the cold chain at a wet market

Insufficient Cold Chain Distribution a Barrier to Entry

In a survey of Chengdu wet markets, post found limited amounts of imported products. The cold chain storage facilities are older-generation models and lack sufficient moisture and temperature controls necessary to maintain product quality on a consistent basis. There is a lack of distributor awareness of food safety practices. There are often breaks in the cold chain during transportation from cold storage to retail or HRI facilities.

III. Differentiating U.S. Products from the Local Competition

Imported meats and produce face strongest competition from domestically produced products. The Southwest provinces are major agricultural producers. Lack of dependable cold chain and the transport time from port cities is a major obstacle. The majority of fruits, vegetables, and meat products offered in hypermarkets and supermarkets are locally produced. U.S. wine faces competition from numerous European and Latin American wines already present in the market.

Selected U.S. Imported Products	Main Foreign Competitors
Red Meat	Canada, Denmark, New Zealand, Australia
Poultry: chicken paws & wing tips	Brazil, Argentina
Oranges	New Zealand, South Africa
California Table Grapes	Chile
Washington Apples	Chile, New Zealand
Cherries	New Zealand
Breakfast Cereal	United Kingdom, Australia, EU
Cheese and Dairy	New Zealand, Australia, EU
Frozen Processed Products	Canada, New Zealand
Wine	Australia, France, Italy, Spain, Chile
Spaghetti sauce/tomato products	Italy, France, EU
Coffee	Japan, France, South Africa
Candy and Chocolate	Switzerland, Italy, France, Belgium, Japan
Nuts	Iran (pistachios), Mongolia, Korea (chestnuts) Russia
Seafood	Russia, North Korea, Canada, Norway, Japan
Ginseng	Canada, Korea
Dried fruit: prunes and raisins	France and Italy (prunes)
Baby food/infant formula	New Zealand, Switzerland
Premium Ice Cream	France, New Zealand

IV. Select Best Product Prospects

Interest in health, safety, and high-end gourmet products has increased with increased income levels. Consumers are increasingly buying produce from supermarkets and hypermarkets instead of traditional markets because they are perceived as cleaner and safer.

Post finds that these trends have led to opportunities for specific products. Health conscious products have been especially popular with the Chinese consumers. Red wine and olive oil have been widely accepted by Chinese consumers. Imported dairy products have increased in popularity due to the melamine dairy scandal, but dairy products face strong competition from New Zealand, Australia, and EU producers already in the market.

While there is strong local competition for meats, fresh vegetables, and fresh fruits, there is demand for specialty products and organic or "green" produce. U.S. imported produce could be successful if it is successfully marketed as a high value product. U.S. muscle meats, as well as chicken paws, wing tips, and other non-muscle meats are strong prospects, especially if sold as a high value product.



"Green" meat products for sale in an upscale Chengdu hypermarket

Select Products Present in the Market Which Have Good Sales Potential:

Poultry; especially chicken paws and wing tips

Oranges

California table grapes

Washington apples

Cherries
Breakfast cereal
Cheese and dairy
Spaghetti sauce/tomato products
Candy and chocolate
Nuts
Seafood
Dried fruit; especially prunes and raisins
Premium ice cream
Baby food/infant formula

Select Products Not Present in Significant Quantities Which Have Good Sales Potential:

Red meat
Frozen processed products
Wine
Ginseng
Peanut butter, other specialty condiments

V. Post contact and further information

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